



Ms. Jennifer J. Johnson

Secretary

Board of Governors of the Federal Reserve System

20th Street and Constitution Avenue, NW

Washington, DC 20551

Re: Regulation II; Docket No. R-1404

Dear Ms. Johnson:

Thank you for the opportunity to respond to the Request for Comment issued by the Federal Reserve Board (FRB) regarding proposed Regulation II and its supplementary information.

As Cashier of Northwoods State Bank, a banking institution in Mason City, Iowa with 134M in total assets, I am writing to express my opposition to the proposed rule. NSB is a Community Bank, a full service bank in North Central Iowa, with 28 employees, and 3 Branch Offices.

If Interchange Income was reduced by 70-90 percent, the proposal would have a serious affect on our institution. Our Financial Institution would be forced to raise fees elsewhere, which would have a negative affect on consumers.

Below are our specific comments regarding each section of Regulation II: the proposed interchange fee, transaction processing restrictions, and fraud-prevention costs.

### **Proposed Interchange Fee**

In order to preserve the intent of the small issuer interchange rate exemption included in the law, we ask that you issue additional rules to guarantee the small issuer exemption in the marketplace and protect the interchange revenue of all small issuers.

As dictated in the law, you need to fully consider the "role" of the issuer in the authorization, clearing, and settlement of an electronic debit transaction. For example: In order to have a transaction processed on the SHAZAM network, an issuer needs to be a network participant. Participation requires the payment of various fees, including but not limited to network fees, participation fees, and debit card residency fees.

The FRB also needs to expand its view of settlement. The primary objective of the Electronic Funds Transfer Act is to protect individual consumers engaging in electronic funds transfers (EFTs). Network operating rules, which also provide consumer protections, require an issuer to maintain responsibility and liability for settlement until a cardholder's dispute rights have fully expired. Any costs incurred by an issuer throughout this settlement process should be considered allowable costs, including the cost of inquiries and disputes; fraud losses and fraud-prevention costs; and fixed costs, including capital investments, used to support settlement.


The law specifies that the interchange fee shall be "reasonable and proportional" to the costs (not the exact costs) to authorize, clear, and settle a debit transaction; therefore, an allowance should also be made for a reasonable profit. If you do not take into account these factors, the proposed interchange cap is not a "reasonable" fee.

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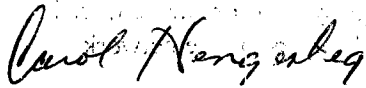
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Finally, Alternative 2 (non-prescriptive) is the better alternative. It is not practical for the FRB to mandate specific technologies. We believe Alternative 1 (technology-specific) would stifle technological changes, as the FRB is not an expert regarding technologies that could reduce fraud.

Because of the many issues related to consumer harm and basic fairness, we urge you to strongly consider each of the points we have addressed in this letter. Thank you for your time.

Sincerely,



Carol Hengesteg  
Northwoods State Bank